Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE
AMERICAN PUBLIC COMMUNICATIONS COUNCIL

Albert H. Kramer
Robert F. Aldrich
DICKSTEIN SHAPIRO MORIN
& OSHINSKY LLP
2101 L Street, N.W.
Washington, D.C. 20037-1526
(202) 828-2236

Attorneys for American Public
Communications Council

September 10, 1996

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Implementation of the Telecommunications Act of 1996	)	CC Docket No. 96-150
Accounting Safeguards Under the Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL

The American Public Communications Council ("APCC") submits the following reply comments pursuant to the Commission's Notice of Proposed Rulemaking ("NPRM"), FCC 96-309, released on July 18, 1996.

I. FCC ACCOUNTING SAFEGUARDS MUST PREEMPT INCONSISTENT STATE RULES

Some state commussions question whether the FCC's accounting safeguards should apply to intrastate costs, even in the area of payphones. California expresses concern about "accounting treatment which places payphone service 'below the line' and arguably removes state jurisdiction over consumer safeguards for payphones and the establishment of public policy payphones." California at 9. In the case of payphones, under Section 276, the FCC is responsible for eliminating intrastate subsidies as well as interstate subsidies of LEC payphone service. 47 U.S.C. § 276(b)(1)(B). Placing payphone service 'below the line' or in nonregulated books; is necessary in order to ensure an end to LEC payphone subsidies and discrimination as mandated by the Act. H.R. Rep. No. 458, 104th Cong., 2d Sess. 158 (1996) ("The BOC payphone operations will be transferred . . . to the BOC's unregulated books").[1]

It is critical that costs and revenues attributable to payphones be vigorously separated at both the interstate and intrastate levels. As just one simple example, the pay telephone services provided to inmates of correctional facilities have levels of bad debt (uncollectible billings) that are much higher than for the telephone industry as a whole -- averaging about 15-20% of total billings. See Comments of the Inmate Calling Services Providers Coalition in CC Docket No. 96-128, filed July 1, 1996, at 12. At present, LEC inmate telephone service operations do not account separately for their bad debt. Instead, those uncollectibles go into a common pool with residential and business bad debt, where the costs are charged back to other ratepayers. Id. at 28. A basic change required by the Act is to segregate the bad debt of LECs' inmate telephone operations so that it is no longer subsidized. Since the bulk of inmate calling services are intrastate rather than interstate, this segregation will not be assured unless the FCC's implementing rules are carrier out at the intrastate as well as interstate level. There are numerous other examples of intrastate payphone subsidies that must be eliminated.

---

1 However, such a change in accounting treatment does not dictate that states be prevented from establishing "consumer safeguards" for payphones. Independent public payphones generally are not subject to rate-of-return regulation, but are subject to consumer safeguards in most states. The same would be true of LEC payphones.

II. PRICE CAP REGULATION DOES NOT REMOVE THE NEED FOR ACCOUNTING SAFEGUARDS

The Bell Companies and various local exchange carriers ("LECs") argue that price cap regulation and competition provide the most effective constraints on the ability of incumbent LECs to cross-subsidize. They essentially argue that once rates are subject to a price cap formula, changes in cost allocations cannot affect prices. They also contend that if the sharing obligation is removed, there are no vestiges of rate of return regulation for which the allocation of costs is relevant.

Several flaws render this argument invalid. First, most states either use price caps with a sharing mechanism or continue to use rate of return regulation. MCI at 6. The sharing mechanism provides a direct incentive for the BOCs and independent LECs to either misallocate costs from the nonregulated operations to the regulated operations, to provide services to affiliates below the appropriate cost, and to purchase services from affiliates at inflated prices. As explained above, in the case of payphones, at least, the FCC is expressly charged with establishing regulations that eliminate both intrastate and interstate subsidies. The Commission may not assume that state commissions will adopt regulations that satisfy the federal requirements. Indeed, many state commissions do not have their own regulated/nonregulated cost allocation rules. Consequently, these commissions implicitly rely on the cost allocation rules of the FCC. Therefore, even if the USTA's assertions were correct that price caps without sharing removes the incentive to cross-subsidize at the federal level, the rules must be capable of preventing cross-subsidy at the state level.

Second, even interstate ratemaking must continue to rely on proper cost allocation. Exogenous cost changes and the introduction of new services (including Section 251 service elements) may require the Commission to review costs. Further, as pointed out by MCI, LECs that choose price caps without sharing today may not necessarily do so in future years. Further, if the Commission intends to monitor LEC performance to evaluate whether its permanent price cap system is in the public interest, or to determine whether adjustments must be made to further the public interest, then the Part 64 cost allocation rules and all related safeguards are essential. MCI at 5-6, 39.

Third, as LDDS Worldcom points out, price caps without sharing does not remove the incentive to discriminate between LEC and non-LEC providers of competitive services such as payphone service. LDDS Worldcom at 32. As APCC explained in its comments, accounting safeguards are necessary to prevent discrimination in a host of services that are needed by IPP providers. Currently, there exists a very strong incentive for the LECs to overprice services for regulated exchange and exchange access services needed by competitors in order to make it difficult for competitors to gain access to network and related LEC services, and to profitably compete. At the same time, the LEC may temporarily offer its own nonregulated services or other competitive services at prices which are below economic costs. Contrary to LEC claims that such price-squeeze strategies are merely "theoretical," LEC has shown that they have both "the practical capability" and "compelling incentives to attempt such anticompetitive pricing strategies" in the payphone market. Southwestern Bell at 12. See Order of the Washington Utilities and

Transportation Commission, Docket No. UT-920174, March 17, 1995 and Order of the Illinois Commerce Commission, Docket No. 88-0412, October 5, 1995. However, to the extent that costs are properly allocated or assigned to the nonregulated operations, if the LEC chooses to price its services at below cost, it will have to do so at a loss. While the BOCs and certain independent LECs have the financial stamina to absorb losses from their nonregulated operations, continuing losses would not be viewed favorably by Wall Street. Until there is effective competition in the local exchange market, it is essential that the Commission continue to employ its Part 64 nonstructural safeguards as proposed to be modified by the APCC.

III. ACCOUNTING SAFEGUARDS SHOULD NOT BE WEAKENED

The USTA lists a host of "other existing incumbent exchange carrier safeguards"[2] which it asserts will prevent cross-subsidization. Many, if not all, of the other listed safeguards have been in existence since the Commission first implemented its nonstructural accounting safeguards and affiliate transactions rules, yet these alleged safeguards have not prevented cross-subsidization. As noted in the APCC's initial comments, there have been a number of audits of LECs affiliate transactions and cost allocations which document cross-subsidization.[3] These "other safeguards" have not prevented such abuses by the LECs. Accordingly, the Commission must strengthen rather than weaken its accounting safeguards.

[2] USTA Comments at p. 4.

[3] Attachment 2 to the APCC Comments. Also see the Comments of MCI at 6-10.

Bell Atlantic proposes that the Commission replace its affiliate transaction rules with a set of four very general principles, and that the Commission rely on the audit and complaint process specified in the 1996 Act to ensure compliance with the arm's length and nondiscrimination requirements of the statute.[4] Without guidelines as to what constitutes an arm's length transaction and nondiscrimination, the audit process will be even more subjective than it is today. Almost any transaction arguably could be rationalized to be arm's length. Accordingly, APCC urges the Commission to reject the proposal by Bell Atlantic and others to lessen the Commission's affiliate transaction rules and nonstructural safeguards.

Cross-subsidization between LECs' regulated and nonregulated operations is extremely difficult to detect, even using the rules promulgated by the Commission. The transactions and allocations between LECs' regulated and nonregulated operations are substantial and complex. Numerous hours of effort are required to fully comprehend the numerous transactions and allocations that take place between a LEC and its unregulated operations or its affiliates. To abandon or weaken the Part 64 rules, as proposed by USTA, would make detection of cross-subsidization virtually impossible. Until there is effective competition in the exchange and exchange access market, the Commission should strengthen its nonstructural safeguards and affiliate transactions rules as proposed by the APCC in its original comments.

---

4 Bell Atlantic Comments at pp. 6-7.

The USTA argues that stronger accounting safeguards would impose costs associated with redesigning LEC accounting systems if some other approach were adopted. However, the benefits of the changes recommended by APCC should outweigh any additional costs. Making accounting information more available to third parties will help deter the LEC from cross-subsidizing, and enhance the Commission's oversight of these transactions. The BOCs and some of the independent LECs are large powerful companies. They can spend significant resources on gaming the regulatory system. Consequently, the more information available to the Commission, state commissions, and third parties the easier it will be to detect cross-subsidization and discrimination. If the Commission does not modify its rules and the related cost allocation manuals as proposed by the APCC, the BOCs and independent LECs will continue to have the incentive and ability to subsidize and discriminate in violation of Section 276.[5]

IV. PUBLIC INSPECTION IS ESSENTIAL

The BOCs are also generally opposed to any meaningful public inspection of agreements between a BOC and its affiliates that must be reduced to writing pursuant to the 1996 Act. For example, Bell South, Bell Atlantic, US West, and Pacific Telesis oppose the Commission's suggestion that internet access to such agreements would be sufficient to satisfy the 1996 Act's public inspection requirement. No good reason is given for not making such written agreements available over the internet, other than the alleged disclosure of confidential information and the inability to know who is reviewing the

[5] Attachment 2 to the APCC Comments. Also see the Comments of MCI at pages 6 through 10.

documents. While some information in such agreements may possibly justify claims of confidentiality, any truly confidential information can be redacted from any contracts placed on the internet. Making such documents available at the BOC's principal place of business, as proposed by Bell South and US West,[6] would severely limit a third party's ability to gain access to such information. The Commission should adopt the recommendations of APCC and require that the agreements be filed with the Cost Allocation Manuals required by the Commission and be available for internet access.

V. OTHER ISSUES

NARUC proposes audit guidelines for joint federal-state implementation of Section 272 of the Act. APCC urges the Commission to pursue similar federal-state collaboration in order to effectively implement Section 276 safeguards against payphone subsidies. However, NARUC states at page 15 of its comments that access to the auditors workpapers should be granted only to state commissions, the FCC and the joint audit team. APCC believes that access to the auditors' workpapers should be provided to any interested party. The workpapers are the meat of the audit and without them the results of the audit are of little help. The workpapers provide substantial additional information over and above what is included in the audit results. To the extent a party disagrees with the results of the audit, this cannot generally be determined unless the backup documentation and work papers are studied in detail. The auditor's interpretation of what constitutes discrimination or cross-subsidy might be entirely different than that of an interested third

6 Bell South Comments at 24; US West Comments at 13.

party. For these reasons, the workpapers to all affiliate and nonstructural safeguard audits, should be available for public inspection.

The BOCs also argue that the Commission should not require the application of its nonstructural safeguards and affiliate transactions rules to transactions between nonregulated operations of the BOCs. The Commission should reject such arguments. Such transactions can affect the regulated operations of the telephone company. Costs recorded in regulated accounts for transactions between a carrier and its nonregulated affiliate, which are assigned to the nonregulated operations, may affect the overall allocation of costs. This exists because directly assigned and attributable costs are used as the foundation for the general allocator. If an unregulated affiliate under charges the nonregulated operations of the telephone company, the general allocator, which is used to allocate common and joint costs will be understated for the nonregulated operations and overstated for the regulated operations. Likewise, if the nonregulated operations of the telephone company provides a service or product to the unregulated affiliate, at a discount or at less than fair market value, any allocation factors that utilize revenue to form the basis of the factor will be understated. When this factor is then applied to the common or joint costs, there will be an under allocation to the nonregulated operations, which in turn, results in an over allocation to the regulated operations. Under these two situations, all of the required expenses would not be properly removed from the regulated operations. The affiliate transaction rules should apply between the nonregulated operations of the carrier and its unregulated affiliates because these transactions can affect the regulated operations through the chaining process. For example, if the nonregulated operations overcharges for a service performed for an unregulated affiliate, and this unregulated affiliate includes this in the cost of providing another service to the regulated carrier, the inflated price would be charged to the carriers' regulated operation. Under this situation, the regulated costs are overstated.

Dated: September 10, 1996

Respectfully submitted,

Albert H. Kramer
Robert F. Aldrich
DICKSTEIN SHAPIRO MORIN
& OSHINSKY LLP
2101 L Street, N.W.
Washington, D.C. 20037-1526
(202) 828-2236

Attorneys for American Public Communications Council